No. 5821

In the United States Circuit Court of Appeals for the Ninth Circuit

ROYAL PACKING COMPANY, A CORPORATION,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

UPON PETITION TO REVIEW AN ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR RESPONDENT

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PREVIOUS OPINIONS

Previous opinions are the opinion of the United States Board of Tax Appeals (5 B. T. A. 55, R. 14–17), reversed by the United States Circuit Court of Appeals for the Ninth Circuit (22 F. (2d) 536), and the opinion of the United States Board of Tax Appeals reported in 13 B. T. A. 773 (R. 19–33).

JURISDICTION

This case involves income and excess-profits taxes for the fiscal year ended July 31, 1919, in the amount of $13,194.26. (R. 33.) The appeal is taken from the final order of redetermination of the Board of Tax Appeals entered October 6, 1928 (R. 33), and the case is brought to this court by

petition to review filed on December 26, 1928, (R. 34), pursuant to the Revenue Act of 1926, c. 27, Sections 1001–1003, 44 Stat. 9, 109, 110.

QUESTION PRESENTED

Did the Board of Tax Appeals err in affirming the determination of the Commissioner of Internal Revenue which disallowed a deduction, claimed by petitioner, of $15,000 representing an alleged loss on the stock of another corporation during the fiscal year ended January 31, 1919?

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057:

> SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;
>
> * * * * *

Treasury Regulations 45 (1920 ed.):

> Art. 144. *Shrinkage in securities and stocks.*—A person possessing securities, such as stocks and bonds, can not deduct from gross income any amount claimed as a loss on account of the shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed

> of. * * *. However, if stock of a corporation becomes worthless, its cost or its fair market value as of March 1, 1913, if acquired prior thereto, may be deducted by the owner in the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness be made as in the case of bad debts. * * *.

STATEMENT OF FACTS

The Board of Tax Appeals found the facts to be as follows (R. 20–22):

Petitioner is a corporation organized under the laws of the State of California, with its principal office at Los Angeles, California, and is engaged in the canning and packing business. It keeps its books and makes its income-tax returns on the basis of fiscal years ending on January 31st. During the fiscal year ending January 31, 1919, it had outstanding capital stock in the amount of $100,000 and a surplus of approximately $20,000.

The Universal Packing Company, hereafter referred to as Packing Company, was organized in the latter part of 1916 or the early part of 1917 and was engaged in the meat-packing business at Fresno, California. Its capital stock as of November 1, 1918, amounted to the par value of $346,400, of which $69,000 was preferred stock and $277,400 was common stock. It erected a plant which was completed during the latter part of 1917 at a cost of approximately $300,000. It had been estimated that the cost of this plant would be $125,000. This

increase in the cost of the plant exhausted its then paid-in capital. It had no credit with banks. To secure working capital it was determined in January, 1918 at a meeting of the stockholders to issue additional stock. Such stock was issued.

Petitioner first and last subscribed and paid for $15,000 par value of common stock of Packing Company. The last purchase was made of the additional stock issued pursuant to the action of the stockholders at the meeting held in January or February, 1918. This latter subscription was paid in the amount of $5,000 on March 29, 1918. At the same time petitioner's president took $20,000 par value of Packing Company stock. Shortly after June 1, 1918, Packing Company made an assessment of $14 per share on its stockholders, both common and preferred. Petitioner did not pay this assessment. In order to avoid the payment of such an assessment petitioner transferred all its Packing Company stock to C. J. Walden. Entries on petitioner's books indicated that $5,000 par value of the stock was transferred to Walden and that Walden had executed his note to petitioner for that amount. No such note was executed and all the stock was from the date of purchase the property of petitioner.

Packing Company operated spasmodically during 1918 and from the beginning made no profits. It was not equipped so as to comply with Federal statutes and regulations relative to meat packing.

It shut down its plant on November 1, 1918, and never reopened. The plant was sold in October, 1919, and the company thereupon was liquidated. The common-stock holders received nothing on their stock.

On or about January 31, 1919, petitioner's president, who owned 95 per cent of its stock, directed its bookkeeper to charge off as a loss as of January 31, 1919, its stock of Packing Company to the extent of $12,000. Such entry was made. At the direction of the president an entry was made on petitioner's books as of January 31, 1920, charging off the remaining $3,000. In 1924 a revenue agent investigated petitioner's books and tax returns and determined that the whole loss was sustained in the fiscal year ending January 31, 1920, and so informed petitioner's president, who then claimed that the whole loss was sustained in the fiscal year ending January 31, 1919. The revenue agent then indicated that if such claim was to be made the entry should be changed so as to reflect this contention. Thereupon entries were made which charged the whole loss to the fiscal year ending January 31, 1919. In determining the deficiency for the fiscal year ended January 31, 1919, the respondent refused to allow as a deduction the entire loss claimed.

The sole issue in this proceeding was previously decided by the Board of Tax Appeals adversely to the petitioner on October 13, 1926. (R. 14–17.)

Appeal was taken by petitioner to this court and upon hearing the Board's decision was reversed (22 F. (2d) 536), whereupon the case was remanded for rehearing.

SUMMARY OF ARGUMENT

The decision of the Board of Tax Appeals was based upon an ultimate fact such as in a jury trial the jury would be instructed to find as the basis for its verdict. The question before the Board was whether or not from the evidence adduced it could be held that the common stock of the Universal Packing Company, owned by the petitioner, had become worthless during the fiscal year in question. If the stock was worthless, petitioner was entitled to deduct it as a loss; if not, no deduction was allowable.

The ultimate question being one of fact, this court will not weigh the evidence to determine that question, but will examine the record only to see whether the finding is supported by any substantial evidence. *Royal Packing Company* v. *Commissioner,* 22 F. (2d) 536; *W. K. Henderson Iron Works & Supply Co.,* v. *Blair,* 25 F. (2d) 538; *Avery* v. *Commissioner,* 22 F. (2d) 6; *Ox Fibre Brush Co.* v. *Blair,* 32 F. (2d) 42.

The finding that the stock had not become worthless in the fiscal year in question is amply sustained by the evidence.

ARGUMENT

I

Petitioner seeks here to have the Court reweigh the evidence as to a question of fact, and there being substantial evidence supporting the Board's decision the case presents no question for review

As this case now comes to this court the single question to be decided is whether there was any substantial evidence before the Board of Tax Appeals to support its finding that common stock of the Universal Packing Company owned by petitioner had not become worthless during the fiscal year ending January 31, 1919. The Board's finding was as to an ultimate question of fact such as in a jury trial would have been submitted to the jury as the basis of its verdict. There is no room for contention here that the law has been erroneously applied, for the statute and Regulations clearly define the results which follow the finding of fact. If it reasonably appeared that the stock had become worthless during the fiscal year in question, petitioner was entitled to deduct it as a loss; if not, no deduction was allowable.

In previous consideration of this case it was said by this court (22 F. (2d) 536, 538):

> Questions of fact are exclusively for the Board, except that we may consider whether its findings are supported by any substantial

> evidence. Senate Committee Report 52, Sixty-Ninth Congress, 1st Session, p. 36.

In *Henderson Iron Works* v. *Blair,* 25 F. (2d) 538, the Court of Appeals for the District of Columbia said (p. 539):

> Moreover a decision of the Board of Tax Appeals, when based upon testimony taken at the trial of an issue of fact, should not be reversed by an appellate court because of a difference of opinion as to the mere weight of the evidence.

So also, in *Avery* v. *Commissioner of Internal Revenue,* 22 F. (2d) 6, wherein the taxpayer sought to have reviewed a decision denying a claimed deduction for worthless debts (a question similar to the instant one), the Circuit Court of Appeals for the Fifth Circuit in refusing review, said (p. 8):

> It is a familiar rule that in trials at law, when different conclusions may be drawn by reasonable men from undisputed facts, the question presented is one for the jury. Such is the case before us. We are not at liberty to substitute our opinion for that of the board on the facts shown on the record, even if we were disposed to do so.

Petitioner's contention here amounts to no more than an attempt to have this court reweigh the evidence and substitute its conclusion for that of the Board. This is not sanctioned, for it has been consistently held that the Circuit Courts of Appeals

in reviewing decisions are limited to consideration of questions of law, as on writs of error. *Avery* v. *Commissioner of Internal Revenue, supra; Ox Fibre Brush Co.* v. *Blair* (C. C. A. 4th), 32 F. (2d) 42; *Bishoff* v. *Commissioner of Internal Revenue,* 27 F. (2d) 91.

It is proper for this court to ascertain whether or not there was evidence sustaining the Board's decision, but we submit that the case otherwise presents no question of law for review.

II

THE BOARD'S DECISION IS SUSTAINED BY THE EVIDENCE

It is well settled that the determinations by the Commissioner of Internal Revenue are *prima facie* correct, and the taxpayer who appeals therefrom has the burden of proving that the Commissioner was in error. *United States* v. *Rindskopf,* 105 U. S. 418; *Wickwire* v. *Reinecke,* 275 U. S. 101; *Botany Mills* v. *United States,* 278 U. S. 282. The burden, therefore, was upon the petitioner to establish by reasonably convincing evidence before the Board that the stock here in question had in fact become worthless during the fiscal year ended January 31, 1919. This court so held in its previous consideration of the case. (R. 23.)

In the opinion previously rendered in this case, the then record was described as "so meager, disconnected, and altogether inadequate, as to leave

the ultimate facts largely to conjecture and speculation." (R. 25.) Notice was therefore given to petitioner that in a rehearing before the Board, the deficiencies of the previous record should be corrected if the case were to be maintained. In any attempt to establish the worthlessness of corporate stock at any given time, it would appear fundamental that proof be adduced as to the then assets and liabilities of the company or that its financial condition at such time be otherwise established. This court indicated the requisite character of such proof when in the opinion rendered on previous consideration of the case reference was made to the lack of evidence as to insolvency. (R. 23.) Yet the present record is also lacking in such essential proof.

From the facts found, it is known that about $300,000 was invested in the plant erected by the Universal Packing Company (R. 20, 32), and that other sums of unknown amounts were invested in equipment (R. 32, 74); that sometimes the corporation held quite a large amount of bills receivable running up to at least $40,000 (R. 32, 77); that the company owned automobiles and trucks and carried a substantial inventory of supplies (R. 77). Against these known facts as to assets no specific evidence of the company's liabilities during the period here in question was adduced by petitioner. While it is known that the company operated at a

loss, the amount of that loss was not shown, and the company operated as late as November 1, 1918. (R. 21.) The evidence discloses that petitioner subscribed for $5,000 par value of the stock and paid for it in March, 1918, and that petitioner's president at the same time subscribed for $20,000 par value of the stock. In view of these facts, it would appear that the company's early lack of credit (R. 20) was not considered as late as March, 1918, as evidence of insolvency.

In view of the known assets and the absence of any evidence as to the company's liabilities during the fiscal year here in question, the Board held that on the record presented it could not be found that the amount of the company's indebtedness, plus its preferred capital stock, exceeded the then value of all its assets by at least the sum of $277,400, the amount of the outstanding common stock. (R. 32.)

What testimony was given by petitioner's witnesses has been carefully analyzed in the Board's opinion, and in view of the detailed character of such analysis, it only seems necessary to refer here to that evidence regarded as sustaining the decision reached.

It has been seen that as opposed to the known assets of the company, its liabilities during the period in question were left on the record wholly as a matter of conjecture. The petitioner's action taken with respect to the record value of the stock during

the fiscal year ending January 31, 1919, is strong evidence supporting the Board's decision. Because of the fact that the taxpayer is one who charges off a loss, any facts disclosing his judgment as to such loss at the time at which the loss was claimed, are of great probative value. While it is not contended that a charge-off is necessary to establish a loss or that the taxpayer's then judgment is conclusive, the action taken with respect to the stock during the year for which the loss is claimed is nevertheless here of substantial evidentiary value. The findings of fact disclosed that the taxpayer in closing its books for the taxable year in question charged off only $12,000 of its investment in the common stock of the Universal Packing Company and permitted the balance of $3,000 to remain on its books until the close of the succeeding fiscal year. (R. 21–22.) Both entries were made at the direction of the petitioner's president, who owned 95% of its stock, and who testified that he was a bookkeeper and "thoroughly familiar with the elements of bookkeeping and accounting." (R. 38.) As was pointed out in the Board's opinion (R. 25) the charge on the books made at the president's direction presumably meant more to him, by reason of his bookkeeping experience, than it would to the average business man.

We have also the further significant evidentiary fact that no change was made in the entries until

1924, or more than five years after the date of the first entry. The change then to a claimed loss of the entire $15,000 for the fiscal year ending January 31, 1919, was made only after the revenue agent investigating petitioner's books had indicated that as the entries stood no loss could be allowed for the fiscal year here in question. (R. 22, 26.)

It thus appears that up to 1924 petitioner's books reflected the view that there had been only a shrinkage in value, and that the stock was not worthless in the year in which this case is concerned. Shrinkage in value of securities and stocks will not be permitted as a deduction for a loss sustained. See Article 144 of Regulations 45, *supra*. We do not understand that the petitioner contests that no loss can be claimed for shrinkage in value.

Upon the foregoing facts and the deficiencies of petitioner's proof as analyzed in the Board's opinion, it is submitted that this case presents no question for review by this court. The argument by petitioner is but an appeal to this court to reverse the Board of Tax Appeals on a different view as to the weight of evidence.

CONCLUSION

It is respectfully submitted that the decision of the Board of Tax Appeals should be affirmed by this court on the ground that there is substantial evidence to sustain the finding of the Board that

the stock in question had not become worthless during the fiscal year ending January 31, 1919.

Respectfully,

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